COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 5177-03
Bill No.: SCS for SB 661
Subject: Corporations; Taxation and Revenue - Income
Type: Original
Date: March 30, 2012

Bill Summary: This proposal would create a tax deduction for individuals' business income phased in over five years, and would gradually reduce the corporate income tax rate over five years.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
General Revenue	($73,213,751)	($145,762,752)	($217,864,424)
Total Estimated Net Effect on General Revenue Fund	**($73,213,751)**	**($145,762,752)**	**($217,864,424)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 10 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
General Revenue	4	4	4
Total Estimated Net Effect on FTE	**4**	**4**	**4**

☒ Estimated Total Net Effect on All funds expected to exceed $100,000 savings or (cost).

☐ Estimated Net Effect on General Revenue Fund expected to exceed $100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of the Secretary of State (SOS)** assume many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The SOS is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. The fiscal impact for this fiscal note to the Secretary of State's Office for Administrative Rules is less than $2,500. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, we also recognize that many such bills may be passed by the General Assembly in a given year and that collectively the costs may be in excess of what our office can sustain with our core budget. Therefore, we reserve the right to request funding for the cost of supporting administrative rules requirements should the need arise based on a review of the finally approved bills signed by the governor.

Officials from the **Joint Committee on Administrative Rules** assume that this proposal would not have a fiscal impact on their organization.

Officials from the **Department of Revenue** (DOR) assume this proposal would provide for an income tax deduction for business income. Additionally, it would reduce the corporate income tax rate over a five-year period.

Fiscal impact

DOR officials stated that for 2010, Missouri individual income tax filers reported $10.4 billion in "business" income on their federal Schedule C, Schedule D, Schedule E, and Schedule F.

Based on that $10.4 billion in business income, and an effective individual tax rate of 4 percent (6% minus modifications and deductions), DOR officials estimated the following reduction in individual income tax:

2012	$21 million
2013	$41 million
2014	$62 million
2015	$83 million
2016	$104 million

ASSUMPTION (continued)

DOR officials noted that some portion of that $10.4 billion amount could have been earned outside the state of Missouri and not been taxable in Missouri. In addition, the $10.4 billion amount does not include any Missouri business income included on a federal return filed by an individual that did not have a Missouri address.

DOR officials stated that for 2009, Missouri corporate taxpayers reported $5.1 billion in taxable income and $319 million in state income tax.

Based on the estimated tax of $319 million, DOR officials estimated the following reduction in corporate income tax:

2012	$32 million
2013	$64 million
2014	$95 million
2015	$128 million
2016	$160 million

Administrative impact

In order to implement this proposal, DOR officials assume Personal Tax would require two additional Temporary Tax Employees for key entry, one additional Revenue Processing Technician I (Range 10, Step L) per 19,000 additional errors, and one additional Revenue Processing Technician I (Range 10, Step L) per 2,400 pieces of correspondence. Corporate tax would require one additional Revenue Processing Technician I (Range 10, Step L) per 7,800 additional errors generated, with CARES equipment and license, and one additional Revenue Processing Technician I (Range 10, Step L) per 2,600 additional pieces of correspondence generated, with CARES equipment and license.

ASSUMPTION (continued)

DOR officials also assume there would be an increase in adjustments to individual income tax returns due to the calculation to reduce taxable income, and that Collections and Tax Assistance (CATA) would have an increase in contacts. CATA would require one additional Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the non-delinquent tax line, including one CARES phone and agent license, one additional Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the delinquent tax line, including one CARES phone and agent license, and one additional Revenue Processing Technician I (Range 10, Step L) for every additional 4,800 contacts annually to the field offices with a CARES phone and agent license.

The DOR estimate of the cost to implement this proposal included two additional temporary tax employees and seven additional FTE. The estimate, including salaries, benefits, equipment, and expense, totaled \$314,614 for FY 2013, \$308,839 for FY 2014, and \$312,083 for FY 2015.

Oversight assumes the DOR estimate of expense and equipment cost for the new FTE could be overstated. If DOR is able to use existing desks, file cabinets, chairs, etc., the estimate for equipment for fiscal year 2012 could be reduced by roughly \$6,000 per new employee.

Oversight assumes that a substantial majority of individual tax filers would use tax preparation software or have their return prepared by a paid preparer, and virtually all corporate filers would have returns prepared by a paid preparer or corporate officer. Accordingly, the number of calculation errors would be significantly reduced over previous years and the DOR estimate of additional FTE may be overstated. Oversight assumes this proposal could be implemented with four additional FTE. Since this proposal would become effective for tax years beginning January 1, 2012 it would first impact tax returns filed in January 2013 (FY 2013). Oversight will include six months cost for DOR in FY 2013.

Oversight has, for fiscal note purposes only, changed the starting salary for the additional employees to correspond to the second step above minimum for comparable positions in the state's merit system pay grid. This decision reflects a study of actual starting salaries for new state employees and policy of the Oversight Subcommittee of the Joint Committee on Legislative Research. Oversight has also adjusted the DOR estimate of equipment and expense in accordance with OA budget guidelines. Finally, Oversight assumes a limited number of additional employees could be accommodated in existing office space.

ASSUMPTION (continued)

IT impact

DOR officials provided an estimate of the IT cost to implement this proposal of $22,260 based on 840 hours of programming to make changes to DOR systems.

Oversight assumes OA-ITSD (DOR) is provided with core funding to handle a certain amount of activity each year. Oversight assumes OA-ITSD (DOR) could absorb the costs related to this proposal. If multiple bills pass which require additional staffing and duties at substantial costs, OA-ITSD (DOR) could request funding through the appropriation process.

Officials from the **Office of Administration, Division of Budget and Planning** (BAP) assume this proposal would not result in additional costs or savings to their organization.

BAP officials assume this proposal would create a new subtraction of taxable individual business income, and would reduce the corporate tax rate.

Individual Income Tax

This proposal would phase in a deduction of business income from individual income tax, increasing from 5% in 2012, 10% in 2013, 15% in 2014; 20% in 2015; and 25% thereafter. Business Income would be defined as income greater than zero arising from transactions and activity in the regular course of the taxpayer's trade or business, and would include income from tangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

The IRS Statistics of Income data for Missouri for 2009 are shown in the table that follows. According to the definitions provided by the IRS and the definition of business income above, some portion of dividend and capital gains income would also likely qualify as business income under this proposal. Therefore, BAP officials estimate that 7.2-12.6% of net individual income taxes are derived from business income.

ASSUMPTION (continued)

Adjusted Gross Income ($ thousands)	$131,801,960
Business Income	$3,720,562
Partnership Income	$5,779,953
Sub-total	$9,500,515
Percent of Adjusted Gross Income	7.2%
Ordinary Dividends	$2,652,847
Qualified Dividend	$2,123,453
Net Capital Gain	$2,317,271
Subtotal	$7,093,571
Percent of Adjusted Gross Income	5.4%
Total	$16,594,086
Total Percent of Adjusted Gross Income	12.6%

In FY 2011, $4,640.3 billion was collected in net individual income taxes. Using the range presented above, BAP officials estimate that $334.1 million to $584.7 million in individual income taxes was derived from business income. Therefore, each 5% subtraction in business income would reduce general and total state revenues by $16.7 million to $29.2 million, beginning in FY 2013. For all years after the 25% reduction becomes effective, there would be a reduction in General and Total State Revenues by $83.5 million to $146.2 million annually, notwithstanding any inflationary growth.

Corporate Tax

The proposal would reduce corporate income tax rates by 10% each year. The current rate is 6.25%. BAP officials assume this proposal would reduce the rate to 5.625% for 2012, 5% for 2013, 4.375% for 2014, 3.75% for 2015, and 3.125% for each year thereafter.

ASSUMPTION (continued)

In FY 2011, $306.1 million was collected in net corporate income taxes. Therefore, BAP officials assume that each 10% reduction in the rate would reduce general and total state revenues by $30.6 million beginning in FY 2013. In the year in which the 3.125% rate becomes effective, general and total state revenues would be reduced by $153.1 million annually, notwithstanding any inflationary growth.

Officials from the **University of Missouri, Economic and Policy Analysis Research Center** (EPARC) assume this proposal would, if enacted, gradually reduce the corporate tax rate by 50% as well as phase in a 25% deduction for business income for individual taxpayers.

Individual business income deduction

The "Business Income" Subtraction for Individual Income Tax Filers was estimated by EPARC officials as income reported on federal Schedules C, E and F, or who reported Partnership/S-Corp income on Schedule E.

Schedule C Income:	$ 4.882 billion
Schedule E Income:	$ 8.444 billion
Schedule F Income:	$ 0.473 billion

The "Business Income" total was $ 13.799 billion.

EPARC officials then prepared a simulation of the impact of the proposal in which the "Business Income" as defined was gradually subtracted from the filers FAGI to arrive at their simulated MAGI - a 5% subtraction for 2012, a 10% subtraction for 2013, a 15% subtraction for 2014, a 20% subtraction for 2015 and a 25% subtraction for 2016.

Using the 2010 individual income tax data as their baseline EPARC officials reported that Net Tax Due was reduced by $37.494 million in 2012 (FY 2013), $74.334 million in 2013 (FY 2014), $110.757 million in 2014 (FY 2015), $146.811 million in 2015 (FY 2016) and $182.436 million in 2016 (FY 2017).

ASSUMPTION (continued)

Corporate tax rate reduction

This proposal would also gradually reduce the corporate income tax rate from 6.25% in 2011 to 5.625% in 2012, to 5% in 2013, to 4.375% in 2014, to 3.75% in 2015, and to 3.125% in 2016.

The latest 2009 corporate income tax data indicated an aggregate liability of $356.317 million. Using this amount as a baseline and reducing the corporate tax rate by the percentages indicated above, EPARC officials calculated a reduction in corporate tax liability of $35.632 million in 2012 (FY 2013), $71.263 million in 2013 (FY 2014), $106.895 million in 2014 (FY 2015), $142.527 million in 2015 (FY 2016), and $178.158 million in 2016 (FY 2017).

Oversight will use the EPARC estimates of revenue reduction for fiscal note purposes

FISCAL IMPACT - State Government	FY 2013 (10 Mo.)	FY 2014	FY 2015
GENERAL REVENUE FUND			
Cost - Department of Revenue			
Salaries - 4 FTE	($44,040)	($88,080)	($88,961)
Temporary employees	($7,800)	($15,756)	($15,914)
Benefits	($27,216)	($54,514)	($55,059)
Equipment and expense	($34,695)	($4,402)	($4,490)
Total	($113,751)	($162,752)	($164,424)
Revenue reduction			
Personal income tax	($37,500,000)	($74,300,000)	($110,800,000)
Corporate income tax	($35,600,000)	($71,300,000)	($106,900,000)
Total	($73,100,000)	($145,600,000)	($217,700,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**($73,213,751)**	**($145,762,752)**	**($217,864,424)**
Estimated Net FTE impact on General Revenue Fund	4	4	4

FISCAL IMPACT - Local Government	FY 2013 (10 Mo.)	FY 2014	FY 2015
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

This proposal would have a direct fiscal impact to small businesses which are subject to state income tax.

FISCAL DESCRIPTION

This proposal would reduce the tax on business income over a five-year period.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Office of the Secretary of State
Joint Committee on Administrative Rules
Office of Administration
 Division of Budget and Planning
Department of Revenue
University of Missouri
 Economic and Policy Analysis Research Center

Mickey Wilson

Mickey Wilson, CPA
Director
March 30, 2012